4Q18 Earnings Conference Call
Edited Transcript

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This transcript has been edited by Chevron Corporation. It is generally consistent with the original conference call transcript. For a replay of the earnings call for the fourth quarter of 2018, please listen to the webcast presentation posted on chevron.com under the headings "Investors," "Events & Presentations."

Transcript

Operator:
Good morning. My name is Jonathan and I will be your conference facilitator today. Welcome to Chevron's fourth-quarter 2018 earnings conference call. (Operator Instructions) As a reminder, this conference call is being recorded.

I will now turn the conference call over to the Chairman and Chief Executive Officer of Chevron Corporation, Mr. Mike Wirth. Please go ahead.

Mike Wirth (Chairman and Chief Executive Officer, Chevron Corporation):
Thank you, Jonathan. Welcome to Chevron's fourth-quarter earnings conference call and webcast. On the call with me today are Pat Yarrington, Vice President and Chief Financial Officer, and Wayne Borduin, General Manager of Investor Relations. We will refer to the slides that are available on Chevron's website.

Before we get started, please be reminded that this presentation contains estimates, projections, and other forward-looking statements. Please review the cautionary statement on slide 2.

Back in March, I laid out Chevron's strategy to win in any environment. I outlined our three compelling strengths: an advantaged portfolio, sustainability at lower prices, and a strong balance sheet. I also indicated that the combination of these distinct advantages, together with the commitments to action highlighted in blue, would deliver growing free cash flow and shareholder returns.

In 2018, we delivered. We grew oil and gas production by more than 7%, achieving our highest-ever annual production. We grew cash margins in our operated upstream assets, contributing to an improvement in cash returns.

We lowered our unit costs, and we sold $2 billion of assets. These outcomes yielded record free cash flow, a dividend increase, and the initiation of a share repurchase program. 2018 was a very successful year and we intend to build on this momentum in 2019.

Turning to slide 4, a view of our sources and uses of cash. Excluding working capital, we generated over $31 billion in cash flow from operations. We achieved record free cash flow of nearly $17 billion, the highest level ever achieved by Chevron in any price environment.

This allowed us to deliver on all four of our financial priorities. For the 31st consecutive year, we maintained our commitment to dividend growth and paid out $8.5 billion in cash dividends to our shareholders. Earlier this week, we announced a $0.07 per-share increase in our quarterly dividend to $1.19 per share, representing a 6% increase.

Second, we allocated capital across a diverse portfolio and funded our highest-return projects. We have confidence these investments position us for sustainable growth and free cash flow.

Third, we strengthened our balance sheet and paid down debt by $4.5 billion. Finally, we began repurchasing shares in the third quarter and increased the rate in the fourth quarter, demonstrating further confidence in our future cash generation.

With that, I will turn the call over to Pat, who will take you through the financial results. Pat?

Pat Yarrington (Vice President and Chief Financial Officer, Chevron Corporation):
Thanks, Mike. Turning to slide 5, an overview of our financial performance. Fourth-quarter earnings were $3.7 billion or $1.95 per diluted share. 2018 full-year earnings were $14.8 billion or $7.74 per diluted share, up more than 60% from 2017.

In the quarter, foreign exchange gains of $268 million were offset by a special item related to a project write-off. A detailed reconciliation of special items and foreign exchange is included in the appendix to this presentation.

For the full year, earnings excluding special items and foreign exchange, totaled $15.5 billion. Return on capital employed for 2018 was 8.2%, up from 5% in 2017. Our debt ratio at year-end was 18% and our net debt ratio was approximately 14%.

During the fourth quarter, we paid $2.1 billion in dividends, bringing the full-year total to $8.5 billion. And we increased the rate of our share repurchases from $750 million in the third quarter to $1 billion in the fourth quarter.

Turning to slide 6, for the full year, cash flow from operations totaled $30.6 billion, about 50% higher than 2017. Headwinds, as we've defined them in the past, totaled $3.2 billion for the year, in line with my original guidance.

For the quarter, cash flow from operations was $9.2 billion. It was lower than in the third quarter primarily because of lower commodity prices, but it was well above first quarter when prices were comparable. This improvement within the year was due to the growth in production.

Cash capital expenditures for the quarter were $4 billion and $13.8 billion for the year. The resulting free cash flow of almost $17 billion reduced our dividend breakeven price. We are covering our cash capex and dividend at just under $53 Brent without consideration of asset sale proceeds. Before moving off cash flow, a little guidance for 2019. If prices hold at current levels, we expect headwinds for 2019 to be between $2 billion and $3 billion.

Now onto slide 7. Full-year 2018 earnings of $14.8 billion were approximately $5.6 billion higher than 2017. Special items, primarily the absence of a US tax reform gain of $2 billion, lower gains on asset sales, and an increase in charges relating to project write-offs, resulted in a net $3.9 billion decrease in earnings. A swing in foreign exchange impacts benefited earnings between the periods by $1.1 billion.

Upstream earnings, excluding special items and foreign exchange, increased by about $9.3 billion between periods, primarily because of higher realizations and increased liftings. Slightly offsetting were higher operating expenses, largely associated with continued ramp-up in production, along with additional taxes and other costs.

Downstream results, excluding special items and foreign exchange, decreased by just over $90 million. Lower volumes reflected the sales of our Canadian and Southern African refining and marketing assets, while higher operating expenses were associated with planned turnaround activity in the US. These items were mostly offset by favorable timing effects and improved results at CPChem.

In the other segment, excluding special items and foreign exchange, net charges for the period increased by almost $750 million, due primarily to higher interest expense and lower tax deductibility for corporate charges. Full-year net charges were $2.3 billion, in line with our guidance. Our 2019 guidance for the other segment remains about $2.4 billion in net charges. As a reminder, though, quarterly results in this segment are nonratable.

Now on slide 8, 2018 production was 2.93 million barrels a day, an increase of 202,000 barrels a day or more than 7% from 2017. This is the highest level of production in the Company's history. Excluding the impact of 2018 asset sales, production grew approximately 8%, or 1% above the top of the guidance range we provided last January. Major capital projects increased production by 227,000 barrels a day as we continue to ramp up production at multiple projects, most significantly Wheatstone and Gorgon.

Shale and tight production increased 132,000 barrels a day, primarily in the Permian, where production grew by more than 70% from 2017. Base declines, net of production from new wells, mostly in the US Gulf of Mexico and Nigeria, were 19,000 barrels a day.

The impact of asset sales, in particular from the US Mid-Continent, Gulf of Mexico shelf, and the Elk Hills field in California, reduced production by 50,000 barrels per day. Entitlement effects in total reduced production by 46,000 barrels per day, 17,000 of which was due to the effect of higher prices during the year. Higher planned turnaround effects, primarily at Angola LNG and Tengiz, reduced production between years by 26,000 barrels per day.

I will now hand it back to Mike.

Mike Wirth:
Thanks, Pat. Turning to slide 9, reserve replacement continues to be a real success story. In 2018, our reserve replacement ratio was 136%. We added almost 400 million more barrels than we produced and divested. This outcome is especially significant because it was achieved while growing production more than 7%.

Our reserves to production ratio stands at a healthy 11.3 years, showing the strength and sustainability of our portfolio. Our 5-year reserve replacement ratio of 117% further illustrates that strength through the price downturn.

Moving to slide 10, we continue to maintain our commitment to capital discipline. Total C&E in 2018 was $20.1 billion. This included approximately $600 million of inorganic spend for which we don't budget, primarily related to bonus payments for offshore leases in Brazil and the Gulf of Mexico.

The stacked bar depicts our organic C&E budget for 2019 of $20 billion. Within this budget, the cash component is $13.7 billion, while the remaining $6.3 billion is expenditures by affiliates, primarily TCO and CPChem. In the 2019 budget, $3.6 billion is allocated to the Permian and another $1.6 billion is allocated to other shale and tight assets.

We expect approximately 70% of our total 2019 spend to deliver cash within two years. Our current spend profile has significantly lower execution risk relative to the past, when we had several large-scale major capital projects underway concurrently.

Turning to slide 11, I'd like to provide an update on our portfolio optimization efforts. During 2018, we received before-tax asset sale proceeds of $2 billion, with the largest contributors being the divestment of our Southern Africa refining and marketing business and our interest in the Elk Hills field in California.

We recently completed the sale of our interest in the Rosebank project, west of Shetlands in the UK. In addition, we expect to close the sale of our interest in the Danish underground consortium in the first half of 2019. And earlier this week, we executed an agreement to sell our interest in the Frade field in Brazil. We continue marketing our UK, Central North Sea, and Azerbaijan assets.

As with all divestments, we are focused on generating good value from any transaction. The progress we made last year is consistent with our guidance of $5 billion to $10 billion in asset sale proceeds from 2018 to 2020.

Turning to the Permian, production in the fourth quarter was 377,000 barrels per day, up 172,000 barrels per day or 84% relative to the same quarter last year. Annual production was up more than 70%. In the Permian, we remain focused on returns. We are not chasing a production target nor are we altering our plans based on the price of the day.

Over the last two years, we transacted more than 150,000 acres through swaps, joint ventures, farmouts, and sales, further optimizing our large land position. In 2018, we had takeaway capacity for oil and liquids that was more than sufficient and we have already added more capacity this year.

We are pleased with our position and leading performance in the Permian. In just two years we have doubled our rig count, increased our resource base, decreased unit development and operating costs, and more than doubled our production. We will provide new guidance for our Permian portfolio in March.

Moving to LNG, the plants at Gorgon and Wheatstone performed well during the fourth quarter and averaged almost 400,000 barrels of oil equivalent per day. This was despite higher summer temperatures in December. Higher temperatures, as you know, generally reduce LNG throughput.

We loaded 329 LNG cargoes from Gorgon and Wheatstone last year. We have now commissioned the Wheatstone domestic gas plant and expect to provide gas to the local market in the next few weeks.

We will begin our routine cycle of planned turnarounds at Gorgon this year. We will be on a four-year cycle with one train undergoing maintenance each of the first three years and the fourth year having no turnarounds scheduled.

We expect turnarounds at the Gorgon trains to last about 40 days. These turnarounds offer the opportunity to perform routine maintenance and also to make small enhancements that increase reliability and throughput. We anticipate significant cash generation from these assets for many years to come.

Slide 14 shows our production outlook for this year, assuming a $60 Brent price. We expect production to be 4% to 7% higher than last year, excluding the impact of any 2019 asset sales. Our growth is largely driven by shale and tight assets and full-year production from Train Two at Wheatstone. These forecasts always need to acknowledge the uncertainties in our business, as noted on the slide. In summary, we anticipate a third consecutive year of strong production growth.

Moving to slide 15, as announced earlier this week, we have signed an agreement with Petrobras America Inc. to purchase its 110,000-barrel-per-day refinery and related assets in Pasadena, Texas.

This addition to our Gulf Coast refining system allows us to process more domestic light crude, supply a portion of our retail market in Texas and Louisiana with Chevron-produced products, and realize regional synergies through coordination with our refinery in Pascagoula. We expect to close by midyear and will provide further updates at our analyst meeting in March.

Now just a few comments about future expectations. We expect positive production trends to continue in the first quarter and throughout 2019, reflected in the 4% to 7% growth forecast. As early as first quarter, we expect additional co-lending to TCO in support of the Future Growth Project.

In downstream, we expect low refinery turnaround activity in the first quarter, which as you will recall from our previous disclosure equates to an estimated after-tax earnings impact of less than $100 million.

Earlier in the call, Pat provided you guidance on cash flow headwinds and corporate charges for 2019. And as we communicated earlier this week, there will be a $0.07 per-share quarterly dividend increase, and we anticipate $1 billion in share repurchases during the quarter.

Moving to slide 17, I'd like to share a few closing thoughts. As I've mentioned before, we intend to win in any environment. As a result of our advantaged portfolio, capital discipline, lower execution risk, strong balance sheet, and record-level free cash flow, we are well positioned to continue to deliver strong shareholder returns.

That concludes our prepared remarks and we are now ready to take your questions. Keep in mind that we do have a full queue, so please try to limit yourself to one question and one follow-up if necessary. And we will do our best to get all of your questions answered.

Jonathan, please open the lines.

Operator:
(Operator Instructions) Phil Gresh, JPMorgan.

Phil Gresh (JPMorgan):
Yes, good morning, Mike and Pat. First question: you talked about the dividend breakeven of $53 in 2018. You've stepped up the dividend here at a higher rate than last year and you are also stepping up the buyback.

So I guess maybe if you could just elaborate a little bit on this, on the breakeven, where you see that going. Is it moving lower and giving you more confidence in the more return of capital? Or just how you think about that calculus.

Mike Wirth:
Well, Phil, we worked really hard over the last few years to get that breakeven down. We were in the 80s [breakeven] not that long ago and have made significant progress in bringing the dividend breakeven down.

We've provided a simple way to think about it in some of our prior definitions. And as we look forward in 2019, we expect the dividend breakeven remains in the area where it was last year.

You see we have strong cash flows coming in right now. Our commitment to a competitive increase in the dividend and the confidence to step up the rate of share repurchases is evidence of our confidence that we have [strong] cash flows coming in. And in any reasonable price environment, as Pat has said, we will be able to sustain those kinds of payouts.

The other thing I will point out is that our capital spending is still the same. We have the ability to provide strong production growth, sustain the cash margins you have seen out of our portfolio, and do that at modest capital spending relative to our history.

Phil Gresh:
Sure. Okay, thank you. The second question I guess would just be on capital spending budget, specifically for 2019. The Permian piece: pretty flattish year over year, which I think you highlighted last quarter.

The non-Permian shale piece is stepping up quite a bit here. And I just want to know if you could maybe elaborate on that little bit. Not to steal any thunder from the analyst day, but is that something that is going to be contributing to this

2019 production growth guidance? Or is that something that you are ramping in 2019 and it would be more of a future contribution?

Mike Wirth:
We are beginning to ramp in the other basins. We have added rigs in all the other shale and tight basins in which we operate. We have seen significant reductions in development costs in the Marcellus, Duvernay, and Vaca Muerta as we have shared the learnings and improvements that are emanating from the large-scale activity we have in the Permian.

The economics of each [basin] are compelling. The EURs are increasing. And while the Permian may be in the spotlight within our shale and tight portfolio, it is far from the only asset that we have.

The other thing that I'd note is we've begun an eight-well appraisal program in El Trapial in the north of the Vaca Muerta. We are currently producing in the southern area Loma Campana, but we are intrigued by the possibilities up in the north at El Trapial and we continue to prosecute that program.

We've also picked up additional acreage in the Narambuena – 25,000 net acres where YPF is the operator. We have a four-well pilot that we plan to execute in 2019 – great potential in Argentina.

We really like our entire shale and tight portfolio. And again, it brings some of the characteristics we have been talking about, which are short cycle time, attractive economics, low development costs, and the ability to generate cash relatively rapidly. The last thing I will say is that it brings a much lower risk profile than multiyear, multibillion-dollar capital projects.

Phil Gresh:
Okay. Thanks, Mike. And Pat, what was the amount of the co-lend for TCO?

Pat Yarrington:
In 2018, the co-lend was zero.

Phil Gresh:
For the 1Q guide. I'm sorry.

Pat Yarrington:
I don't have a confirmed number for you because it will depend on what happens to price. It will depend on how cash flow generated from operations matches against the investment profile for the project. It will also depend on the dividend distribution requirements for the partners.

But order of magnitude, if you go back and you look at 2016 when we first started the co-lending, it was about $2 billion. And as a base, think about $2 billion for this year. But we reserve the right to change that number as the year progresses and we see what happens to prices, investment profile, and dividends.

Phil Gresh:
Thanks, Pat.

Operator:
Paul Cheng, Barclays

Paul Cheng (Barclays):
Hey, guys. Good morning. You talk about Argentina. I'm wondering, given the political environment, the infrastructure or lack of infrastructure over there, how quickly you think you can proceed with the development plan? And any kind of timeline or the pace or the capital outlook, any kind of data that you can share?

Mike Wirth:
We will talk about this more in March, Paul. But I'd just reiterate: YPF has been a very, very good partner there. The Macri government is committed to improving the investment climate in Argentina and has instituted a number of reforms to encourage and support energy development in the country.

We have a great resource there that's benefiting from Permian learnings and competitive economics. We've picked up multiple blocks and much of the production can stay in the country.

At this point, the infrastructure is not developed the way that it is in the United States or perhaps North America more broadly, but there is a commitment on the part of the government to [develop the infrastructure]. We will pace our development with gas and liquids takeaway and market conditions.

The realities on the ground in Argentina are a little bit different, but the resource is tremendous, and we are very encouraged by the policy reforms that have been put forth by the government.

Paul Cheng:
And for Pasadena, the refinery that you just bought, what's the game plan for that facility? I mean, are you going to need to make a significant investment up front to bring them to the Chevron standard? Because that facility probably has been underinvested at least for 20 if not 30-plus years. And the labor relationship has been always very rocky.

So what's the game plan? And how much is the upfront investment? And secondly, are you going to run it as a full-blown facility or that is sort of by an extension of Pascagoula?

Mike Wirth:
Let me try to respond to that, Paul, as best I can. We just executed an agreement this week. We don't expect to close until somewhat later in the first half of the year. It's a little premature for me to lay out an investment plan until we close the transaction.

During due diligence, we satisfied ourselves that we can operate the facility safely and reliably at the standards that we would expect. I don't think you should have any concerns there.

It meets our three primary criteria. One: we are getting it at a good price, and one of the ways that you take risk out of refinery acquisitions is to not overpay. I don't think that we are overpaying for the asset.

It is in a great location that allows us to integrate the increasing light crude production out of West Texas. It allows us to serve our markets in Texas with product that we run through our own system as opposed to exchanging or purchasing product. And it will allow us to optimize and integrate with the Pascagoula refinery.

The third criterion is providing strong economics. Because of our system and the three strategic levers that I just talked about, we should be able to optimize that refinery as a part of our system in a way that is different than what the current owner can, simply because it doesn't have our other assets and positions.

Within our business, it fills a gap. It gives us the ability to capture value in multiple different dimensions. And over time, we will evaluate what investments we may choose to make there, as we would in any other refinery.

I would expect future [investments] to be relatively modest, thoughtfully paced over time, and to fit within the level of spending that we have established over the past years in our downstream business.

Paul Cheng:
Thank you.

Operator:
Neil Mehta, Goldman Sachs.

Neil Mehta (Goldman Sachs):
Good morning, Mike and Pat and Wayne here. The first question I had was around Tengiz and the latest on the project. Are you feeling good about the timeline? And thoughts on costs and the contingency as well.

Mike Wirth:
Neil, I probably don't have a lot to add to what we have previously said. We are still on schedule and are targeting a 2022 startup.

As Jay mentioned on our second-quarter call, onsite productivity has improved. We had a very good summer. The logistics are working very well as we are now moving modules from Korea to the staging points.

We can't move through the inland waterway system during the wintertime because it freezes, but modules are arriving from Korea, Italy, and Kazakhstan. The quality levels are very high.

We are about halfway through the project, and 2019 will be a key year. There is a lot of activity in terms of moving modules into the Caspian to the site, and a lot of fieldwork where we will see if these [2018] productivity gains can be built upon again in 2019. This is a year where we will reduce uncertainty.

Jay will be there next week. And when we get to New York in March, he will have had recent field visits to Kazakhstan and Korea. He was in Korea visiting the module fabrication yards last week and so he'll be in a position to give you good insight into where we stand and our expectations.

Neil Mehta:
Yes, looking forward to that. And the follow-up: we just want to get some more color on the share buyback. To follow up on Phil's question, I think most of us were expecting $750 million. It came in at $1 billion in the fourth quarter.

As we think about the share buyback program, our view had been that this program would be kind of a baseload $3 billion program into perpetuity, but you are demonstrating that you are willing to flex and lean into it. Can you talk about the philosophy behind that share repurchase program? Is a higher run rate potentially sustainable? And how you think about flexing it from a big picture and then a more granular perspective?

Mike Wirth:
I'm going to let Pat take that.

Pat Yarrington:

Neil, thanks for the question. The key word here is sustainability. What you saw with our increase was the confidence that we have in our future cash generation, and a belief that we could move the rate of quarterly purchases up to ~~$4 billion~~ [correction: $1 billion].

When we first initiated [share repurchases] in the second-quarter call, the point I made was we wanted to have this [program] be sustainable through the cycle. We pegged it at $3 billion because we thought that would be supportable through any reasonable price environment.

We obviously had stronger prices in 2018. They have come off a little bit, but we still feel very strong about our cash generation in 2019 and the years to come.

We released an 8-K this morning that talked to the fact that our Board supported a resolution for a $25 billion share repurchase program with no term limit. The $25 billion level gives you an indication of the commitment that we have to this program, and our view about its sustainability. That should be a very strong message to our investors about our willingness and intent to boost shareholder distributions.

Operator:
Jason Gammel, Jefferies.

Jason Gammel (Jefferies):
Thanks very much. Hello, folks. I wanted to ask a question about the cost structure of the Company. And the reason I ask is you have already taken a lot of cost out of the upstream, but you seem to be with divestitures and some explorations concentrating more and more into the highest-quality assets.

I am just wondering if there is the potential to take further overhead out of the business through medium-term shutting down regional offices, etc. This seems to be right out of the Mike Wirth downstream playbook of taking further cost out and enhancing returns through concentration.

Mike Wirth:
Jason, I will give you the short answer and the answer is yes. In a commodity business you always have to be looking for efficiencies. Scale matters and we need to continue to look for ways to control our own destiny. A big part of that is moving [capital] into assets that have inherently lower cost structures and continually seeking an efficient overhead structure to support that [investment].

Not only can you do that through conventional means and the way that has always been done, but technology today offers us the ability to do even more. As we bring digital technologies into our business and do things in a business that grew up in an analog world, there is a lot of opportunity to find more efficiencies.

The other thing when you are growing your business, it's important to pay attention to unit costs, and we have seen unit costs come down significantly. We expect another 2% reduction in unit costs this year. As you look out to 2020 and 2021, I think that reduction can increase even more.

We need to be competitive in any price environment, and we will continue to work on cost efficiencies across our entire portfolio.

Jason Gammel:
Appreciate your thoughts, Mike. Just a very quick follow-up. Can you talk about the ramp-up progress at Big Foot?

Mike Wirth:
We have the first well online and it's been performing very well. It came on in November of last year. The second well is currently being drilled and completed and we anticipate it coming on [production] in the first quarter. We will steadily move through the process of adding wells at Big Foot and you can expect it to be part of the production story in 2019.

Jason Gammel:
Appreciate your thoughts. Look forward to seeing you in March.

Operator:
Paul Sankey, Mizuho.

Paul Sankey (Mizuho):
Good morning. You mentioned that you've done about 150,000 acres of swaps or sales I believe in the Permian, Mike. And hi, Pat, by the way. Sorry, I was slightly caught off guard there.

I wanted just an update on where your final numbers are for Permian acreage. And how you feel about that, given that there's potentially some fairly major assets available. I guess you are strongly outperforming your volume targets. Can you also talk about your returns there? Because there's concerns that you are perhaps not as leading-edge as we might want you to be in terms of your Permian performance on a returns basis. Thanks.

Mike Wirth:
We will share a lot more detail in March. As you can see, the performance out of the Permian continues to be exceptionally strong. With the large land position that we have, we have currency and optionality to try to improve [our land position]. Everyone is interested in drilling longer laterals and finding contiguous development areas.

With 2.2 million net acres [in the Permian] and 1.7 million in the Midland and Delaware Basins, we have multiple levers with which to optimize our position. The nice thing about these transactions is they are truly win-win. There is enough economic value that you are creating a bigger pie for both parties.

Our currently disclosed [Permian] resource is 11.2 billion barrels. That is a figure we would expect to grow. Our confidence in the Permian is higher today than it was the last time that I spoke to you.

We put out data before on the returns that we are seeing and they're in the 35%-plus range as we moved to longer laterals and a new basis of design. Even in a modest price environment, we are seeing very, very strong returns. It's as good or better than any other investment we could be making.

We are returns-driven. I mentioned that in my prepared remarks and I will reiterate that. It is returns across the lifecycle of the asset and across the entire value chain. We are not looking to put the most wells online or have the biggest IPs (initial production rates). We are looking to get the best returns out of the system.

For several years we have told you we were going to grow to a 20-rig fleet. And as you go through that kind of growth, you stress the system.

We are pausing in terms of adding rigs at this point in order to ensure that anything that needs to improve from a performance standpoint will. We engage in regular benchmarking within the basin. We have a number of non-operated joint ventures where we have good visibility into what other operators are doing and their performance levels. We are continuing to improve performance in every dimension and will use benchmarking to identify the areas where we can get better.

Jay will talk a lot more about this in March. We'll have a breakout session that will give you a chance to go into detail with questions as well. We are delivering better performance.

Across the value chain, I mentioned we've been well situated with takeaway capacity and we've already added capacity in 2019. We're able to capture margin across the value chain, and later this year that will include refining margin.

Paul Sankey:
Thanks, Mike. And we know also that you have got an advantaged mineral right position there, which seems to be one of the issues with any potential major deals that might occur in the Permian in the near future.

Mike, if I could ask you another one. I was going to make some elaborate joke about you keeping it competitive by not having just the CEO on the call but also the CFO. But obviously referring to Exxon's CEO being on the call this morning.

There is a major number of major differentiations between the two companies and one of them is your flat CapEx outlook. I think that you would do well to maintain that. I think it is a relatively long-term outlook as it stands. You have just drifted towards the top of the range without going above it.

What are the prospects of you actually seeing falling CapEx and CapEx that surprises to the downside going forward, given that your growth trajectory looks very good for a company of your size? Thank you.

Mike Wirth:
We are committed to capital discipline. We can grow our business at modest capital levels. And at times we have good investment options in which we don't invest [don't compete for capital].

Last year, there were two notable examples. We relinquished our rights to the Tigris development project in the Deepwater Gulf of Mexico, not because it is not a good project or can't generate a return, but because we have better opportunities within our portfolio.

The same thing applies to Rosebank. It was a good project with a lot of resource, but one that probably fits better for someone else than it does for us, given our investment alternatives. We will continue to make those kinds of choices.

The one thing that came up in the call earlier was the other shale and tight opportunities. Those are very economic as well. In the Permian and other areas, there are highly attractive opportunities to invest further capital, generate strong returns, and minimize execution risk.

[Production] was up 5% 2 years ago, and 7% last year. We outlined 4% to 7% this year. A growing portfolio over time does require modestly higher base capital spending.

Still, we are committed to capital discipline. And I think you have characterized well our ability to grow at relatively flat capital [spend level]. We will update forward views beyond what we have already articulated when we get to the March meeting.

Operator:
Blake Fernandez, Simmons.

Blake Fernandez (Simmons & Company):
Hey, folks, good morning. Two questions for you. One: could you talk a little bit about Venezuela? I know it's early days, but obviously you do have exposure there, both upstream and downstream. And just any helpful thoughts that might help us out on our end.

Mike Wirth:
Yes, I can give you a quick update on Venezuela, Blake. The first and most important thing for us is the safety of our people on the ground. And so that is what we are really focused on. We also want to be sure the operations where we have an interest are safe and environmentally sound and I can tell you that is the case.

We have worked closely with the government to be sure that we understand the intent of the sanctions. There have been a number of new general licenses issued by the Treasury Department. We are in close consultation to be sure we understand them and how they are to be applied.

And I will say that the US government has been very interested in engaging with us to understand our position on the ground. We continue to operate, and I think for the foreseeable future, we feel like we can maintain a good, stable, and safe operation on the ground in Venezuela.

If you look at it from the downstream side in the US, Pascagoula is the one refinery of ours that tends to run Venezuelan crude. And it runs 70 to 75 thousand barrels, give or take. For some time, the prospects of actions like this have been clear and so we have had contingency plans in place. We have secured alternate sourcing.

We have plenty of crude in-tank for Pascagoula, and we have crude on the water there. We are in good position for the balance of the first quarter and maybe even a little bit beyond. And we have activated our contingency planning into a full-scale execution.

We will keep the refinery full with crude. We will optimize, and we feel like we are going to be able to navigate through this. Our biggest hope is for stability on the ground in Venezuela and the safety of not only our employees but also our contractors and the people in Venezuela.

Blake Fernandez:
Okay, appreciate that. The second question: I know you've kind of covered Pasadena and we will get some additional color in March. But just more broadly speaking, I think you have kind of alluded to a potential acquisition of a refinery on the Gulf Coast for some time.
The size of this is 110,000 barrels a day or so, which isn't small, but it's not really large in context of some of the Gulf Coast facilities. Does this satisfy kind of your appetite or integration potential there? Or do you think there is additional scope to kind of expand that over time?

Mike Wirth:
I don't want to speculate. We have one transaction here that we've signed an agreement on. The key is value and the ability for it to not only yield value on a standalone basis, but to integrate into our network and be sure we can [fully] capture value. We are focused on [capturing value] with the Pasadena refinery and I think I will just leave it at that.

Operator:
Roger Read, Wells Fargo.

Roger Read (Wells Fargo):
Yes, thank you. Good morning. I know all the really fun stuff has got to wait to March, but maybe to take a look at your CapEx mix. You mentioned 70% has a 2-year or less weighting to cash flow, whereas the rest obviously longer.

Do you think as we not so much look at a total CapEx number but the mix within that CapEx, does that start to change back over the next couple years? I'm thinking number one: you signed a long-term deepwater rig contract obviously aimed at some of the more challenging parts of the Deepwater Gulf of Mexico.

So as things like that start to come in, do we see that start to move maybe to more of a 50/50 on CapEx? Or is that something you want to maintain maybe more at the 70/30 level as we think over the next several years?

Mike Wirth:
Yes, Roger, it's a good question because our mix has shifted very dramatically from where it was not long ago. And [total capex] has come down by 50% from the high-water mark and it's shifted in terms of its makeup. I think both aspects are really important.

Going back to Paul Sankey's question, I think this is the new normal for us. We have in this year's budget a little bit over $5 billion for shale and tight: $3.6 billion in the Permian, $1.6 billion on other shale and tight. And over time, I think that number is likely to grow rather than shrink.

We have FGP, which is in the peak spending years this year and next. And that is a nontrivial amount – a little bit over $4 billion in this year's budget. As [FGP] moves past the peak and comes down, it creates room for other investments, and that could include deepwater. It could also include more shale and tight or other major capital projects.

On the deepwater, our intent would be to have a ratable development program. And one of the things that we have learned over this past cycle, is that when we had many large MCPs underway simultaneously, it introduced real execution risk.

Our intent would be to have a balanced approach as we go forward and not to find ourselves so overly skewed to that level of [execution] risk that it becomes an issue that's difficult to manage. And because we have a really strong shale and tight portfolio, plus our base business, which again requires investment but is typically short cycle and quick to go from capital spent to cash in the door, the kind of [capex] range that we are in today is more likely to be the range you would see in the future as opposed to something that flips back the other direction.

Roger Read:
Okay, thanks for that. And then just to beat the Pasadena refining horse a little bit harder here, part of the acquisition indicated some undeveloped acreage. Are we wrong to think about this as just a refining acquisition and maybe should think about it more as an infrastructure opportunity across the board? I'm thinking we're moving more and more towards crude exports from the US.

Mike Wirth:
No, there's a reason we disclosed that, because the asset there is not simply the refinery, but it is the port access, the tankage, and the land. I mentioned a couple of times that our goal is to integrate [the refinery] into our upstream, downstream, and trading system.

And when I was a young pup, one of the lessons I learned from a seasoned engineer in one of our refineries is that the cheapest process unit we have in this refinery is called a tank. There are times when we can fall in love with building complex equipment. And there are realities that you can create optionality and margin through infrastructure and commercial activity at relatively low investment.

This asset offers us the opportunity to not just participate in the refining margin but also to look at the other ways through our integrated system that we can capture value across the entire value chain, both upstream and downstream. And that is the way we are approaching this [investment].

Roger Read:
Great, thank you.

Operator:
Sam Margolin, Wolfe Research.

Sam Margolin (Wolfe Research):
Good morning. Mike, I'm going to try to not ask you to say the same thing again in a different way. But one of the outcomes of the much-faster-than-expected Permian growth is maybe that the free cash flow profile of the Permian as a standalone entity has been pulled forward significantly.

And maybe that is sort of an obvious statement or it is not new. But it seems like that is an important pendulum swing with respect to how you might think about additional long-cycle projects.

So among all these other factors that are sort of -- that you have commented on kind of pointing you to thinking about expanding the portfolio in deepwater or other long-cycle areas, is that something that's important, too? Or is that more something that is on plan and you are just thinking about that within the buyback and the dividend growth and all your other sort of uses of cash that are out there?

Mike Wirth:
The increased performance of the Permian is a good news story. We did spend a little more capital last year because we are finding that we can drill more wells. We have changed our basis of design.

A little bit of the capital overrun was related to the good news story that we are getting a lot more production out of the Permian. And our guidance has been we are free cash flow positive in 2020 and that is still a good way for you to think about it.

We have increased the dividend and Pat has already addressed the confidence in increasing the rate at which we are repurchasing shares and our intent to sustain that through the cycle.

Having strong free cash flow creates alternatives. And we intend to use the free cash flow to be very mindful of the need for shareholder distributions and also to look for good investment opportunities. I mentioned we were able to meet all four [financial] priorities this last year in terms of dividend, investment, balance sheet, and share repurchases, and our intent is to continue to meet those going forward. This growth in free cash flow allows us to do that.

Sam Margolin:
Okay. And just on a related note; I guess this one is for Pat. Is there -- leverage came down a lot. Is there a target leverage to think about conceptually? Or is it just something that is going to be a function of commodity prices in terms of the rate at which the balance sheet fluctuates here?

Pat Yarrington:
As I've said, we don't have a target leverage rate. We think of the balance sheet as being the outcome of other previous outstanding decisions about how we use the cash that we are generating.

As I have said in the past, consider a 20% leverage ratio on average through the cycle. When you are in a stronger price environment, you would obviously build back your balance sheet, and when you are in a weaker price environment, you would utilize it. That's the area in which we are trying to operate.

Having a good balance sheet is a good insurance policy. And having a good balance sheet is an important component that allows us to sustain both dividends and share repurchases through any period of price weakness.

Operator:
Alastair Syme, Citi.

Alastair Syme (Citi):
Hi, thanks for taking the question. It was really just one on your view on the state of the Gulf Coast chemical polyethylene market and how that makes you think about potential expansion plans. Thank you.

Mike Wirth:
Yes, we are still very positive on the petrochemical investment opportunity. And particularly here in the United States, it is a good long-term story.

We have seen some pressure on margins recently because feedstock costs in the third quarter were up. Olefin chain margins have been under a little bit of pressure, but these things happen in commodity markets with long cycle times for projects and ebbs and flows in the economy. That hasn't fundamentally changed our view on the attractiveness of the sector.

Operator:
Doug Leggate, Bank of America Merrill Lynch.

Doug Leggate (Bank of America Merrill Lynch):
Thanks. Good morning, everyone. And Mike, we always appreciate you getting on these calls, so thanks again for doing it this time around.

Mike, my question might actually be for Pat. Pat, you talked about the $13-billion-plus of cash spending. Can you give us an idea as the affiliate spending rolls off with Tengiz completed, how do you anticipate that cash CapEx to trend, given that you are holding the line on the $18 billion to $20 billion absolute spending at least through 2020?

Pat Yarrington:
Mike has answered that question in a way, although he didn't split out cash versus total headline C&E. TCO spending comes off as we move towards first production there in 2022. The other affiliate where we have potential [significant] investment opportunities would be CPChem.

And what occurs in [affiliate C&E] will be a function of final investments decisions made on projects going forward – CPChem, for example. It's not something that I can predict with any degree of certainty.

What is important is that the summation of both Company and affiliate is certainly staying within the $18 billion to $20 billion C&E range for the near term. We will give you an update in March on a longer period of time.

Capital discipline is a theme that you want to read through all of this. The fact is that we have the opportunity to be judicious and selective about how we work additional projects into our queue.

Doug Leggate:
I know it's a tough one to answer, given all the variables. My follow-up is kind of related, I guess. But if we go back to 2010, 2011, 2012, through 2014, 2015, obviously a lot of big oils, yourselves included, were spending much higher levels than you are today. And one assumes that that created a lot of cost recovery barrels in some of the PSCs.

So I guess my question is to the extent you can, as we look forward in light of Thailand, how do you see your entitlement barrels trending if you maintain that CapEx at these levels? Do you start to see cost recovery barrels tail off? And if you can maybe offer some quantification of that, I would appreciate it.

Pat Yarrington:
Doug, we don't have numbers here that we can isolate for you on that. Cost recovery applies across a number of locations in our portfolio. You are obviously aware of what happened in Indonesia. I don't think I have a pinpointed answer that I can give you on that.

Doug Leggate:
All right. It was worth a try. Thanks, folks.

Operator:
Doug Terreson, Evercore ISI.

Doug Terreson (Evercore ISI):
Good morning, everybody. Mike, I have a question about portfolio optimization and specifically the divestiture part of the plan. And on this point, you guys have had a pretty active program over the years, but you still also have a decent amount of value left in the queue.

So my question is, is this because the market for assets has softened somewhat? Or do you consider it to be kind of normal course of business during the cycle or is it something else? So any color on your divestiture program and the market trends you guys are experiencing is really the question.

Mike Wirth:
I'm not 100% sure I'm tracking with you there, Doug. We have always had a program of divestitures, and at times it's a little bit higher and at times it's a little bit lower.

In this business, you are continually looking to upgrade your portfolio. We have some [investments] now that are really attractive. Earlier I mentioned a couple of [investments] that we stepped away from because we didn't think they would compete for capital.

Divestments are driven by a view on strategic alignments. With our broader portfolio and our view of the future, the resource potential that remains in a particular asset, will it compete for capital within our portfolio. And there are good [assets], as I mentioned earlier, that cannot [compete for capital]. And can we receive fair value [by divesting].

[Receiving fair value] may be a function of the macro environment and the forward view on commodity price. But we are in a position that you can expect us to continue to high grade our portfolio.

Doug Terreson:
Yes. So Mike, maybe I should have asked it differently. So it seems like you guys are experiencing healthy enough appetite for assets if you were a seller. Is that a good way to think about it?

Mike Wirth:
Yes, everything we are talking to people about [divesting] right now, we are likely to receive very good value.

Doug Terreson:
Okay, thanks a lot.

Operator:
Biraj Borkhataria, RBC Capital Markets.

Biraj Borkhataria (RBC Capital Markets):
Hi, thanks for taking my question. It was actually on the reserve replacement. In 2018, you had 136%; that was a pretty impressive figure, given the growth trajectory over the last few years.

I was wondering if you could just disaggregate some of the impacts there, particularly on the price impact in terms of revisions from 2017 to 2018. And then what the key moving parts were. Thank you.

Mike Wirth:
Yes, we did have another strong year. Our largest adds came through our Permian shale and tight activity, other shale and tight, Gorgon and Wheatstone. So, primarily in the unconventionals, but contributions across the board from Australia, Canada, Asia, Gulf of Mexico, Eurasia.

Price was a relatively small negative revision, less than 100 million barrels on price. We produced just short of 1.1 billion barrels. We sold about 60 million barrels. There was not a big price impact in there. And while unconventionals were the big piece, we had contributions from other areas.
The one thing that I would call your attention to is what we view as very high-quality reserve additions. They are barrels that bring with them lower execution risk, lower geologic risk, and lower breakeven prices.

We expect to continue to have a good strong reserve replacement story as we go forward, given the quality of our portfolio and the continued improvements that we see, particularly in our unconventional development activities.

All right, well, that is the top of the hour. I want to thank everybody for your time today. I appreciate your interest in Chevron and everyone's participation on the call. I look forward to seeing many, if not all of you in New York City in March. Thanks very much.

Operator:
Ladies and gentlemen, this concludes Chevron's fourth-quarter 2018 earnings conference call. You may now disconnect.